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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

JUN 21 1993

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of)

Implementation of Sections of the)
Cable Television Consumer)
Protection and Competition Act of)
1992: Rate Regulation)

MM Docket 92-266

PETITION FOR RECONSIDERATION
AND CLARIFICATION

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SUMMARY

Viacom International Inc. hereby petitions the Commission to reconsider or clarify various aspects of its Report and Order adopting rules implementing the rate regulation provisions of the Cable Television Consumer Protection and Competition Act of 1992. Specifically, Viacom urges the Commission to:

- Recalculate the benchmarks to correct for serious methodological errors that have overstated the effects of overbuild competition on rates and created a bias against larger, higher cost, and urban systems;
- Allow cable operators to recover by means of pass-throughs the full capital investment in system expansions and upgrades;
- Remove the discrimination between affiliated and unaffiliated programming services in measuring the allowable pass-through of programming costs absent any record of abuse;
- Remove an undue incentive to offer new programming services on an a la carte basis by allowing cable operators an opportunity to earn a profit on their programming costs;
- Allow the recovery of external costs incurred since

- Permit unobjectionable rate adjustments to take effect pending review of other rate changes;
- Modify the procedural rules in recognition of the fact that Due Process may require evidentiary hearings in certain situations;
- Allow settlement of cost of service rate cases by franchising authorities and cable systems;
- Allow cable operators flexibility in determining how best to return excess earnings to the public; and
- Clarify when the offering of a la carte programming services constitutes an evasion of the Commission's Rules.

Viacom respectfully submits that these modifications will not only improve the Commission's rate regulatory regime, but will better allow that regime to meet the public interest objectives the FCC and Cable Act seek to promote.

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PETITION FOR RECONSIDERATION
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Viacom International Inc. ("Viacom"),¹ by its attorneys
and pursuant to Section 1.429 of the Commission's Rules,²
hereby seeks reconsideration or clarification of several
aspects of the Commission's Report and Order ("Order")
adopting rules implementing the rate regulation provisions of
the Cable Television Consumer Protection and Competition Act
of 1992 ("the Cable Act" or "Act").³ As detailed below,

¹ Showtime Networks Inc. ("SNI"), a wholly-owned subsidiary of Viacom, owns and operates the premium program services Showtime, The Movie Channel, and FLIX. MTV Networks ("MTVN"), a division of Viacom, owns and operates the advertiser-supported program services MTV: Music Television, VH-1/Video Hits One, and Nickelodeon (comprising the Nickelodeon and Nick at Nite programming blocks). Viacom also owns Showtime Satellite Networks Inc., which distributes SNI, MTVN and third-party program services to owners of home television receive-only earth stations nationwide. Through wholly-owned subsidiaries, Viacom also holds partnership interests in Comedy Central, Lifetime Television and All News

reconsideration of these aspects is necessary to ensure availability of cable service to the public at affordable rates, and to maintain sufficient incentives and cost


Due to the significant methodological errors in the Commission's calculation of benchmark rates, Viacom respectfully petitions the Commission to recalculate its benchmarks. In doing so, Viacom asks the Commission to take into consideration the resulting benchmark error (13% instead of 10%) and the different costs of providing cable service in different regions of the country. At a minimum, the Commission certainly should not rely on its flawed analysis for any other purposes, including ordering further reductions in rates.

II. PERMISSIBLE "PASS-THROUGH" COSTS MUST ADEQUATELY AND FAIRLY REFLECT THE COSTS OF DOING BUSINESS

It is well established that effective rate regulation requires balancing the interest in ensuring reasonable rates to consumers with the need to allow the regulated entity sufficient revenue "to ensure confidence in the financial integrity of the enterprise, so as to maintain its credit and

essence on a static analysis, they do not recognize changes in the costs of operating the system over time.

In order to allow for these "going forward" changes, the Order identifies several categories of exogenous or external



operators will be limited in their ability to recover the costs of system improvements -- including the capital investment -- by the annual GNP fixed weight price index ("GNP-PI") ceiling on rate increases,⁷ unless cable operators undertake the additional time and expense to prepare and file a cost of service case.

Viacom respectfully submits that not allowing cable operators to pass through (treat as external) the costs of system improvements will inadvertently impede the achievement of several important national policies. Both the Cable Act and longstanding policies of this Commission have established as important aspects of national communications policy (1) the promotion of diversity in information generally and video programming in particular and (2) the increased investment in

their investments in custom expansion and upgrades such as

Commission has continued to encourage cable companies to invest in infrastructure development in recent years.¹¹ Now, in an era when Congress is considering proposals for "information superhighways" and similar concepts, the public interest in improved cable systems seems even more compelling.¹²

The Cable Act also recognizes that system improvements are a necessary means to further the substantial national interest in greater programming diversity. Indeed, an explicit policy objective of the Cable Act was to: "ensure that cable operators continue to expand, where economically justified, their capacity and the programs offered over their

¹¹ See Teleport Communications-New York, 7 FCC Rcd 5986 (1992). The Commission has invoked the same broad policy in other telecommunications markets, including ones potentially competitive with cable. See Telephone Company-Cable Cross-Ownership Rules, 7 FCC Rcd 5781 (1992) (Second Report and Order, Recommendation to Congress, and Second Further Notice of Proposed Rulemaking) (authorizing telephone companies to provide "video dialtone service"). In that decision, the Commission explicitly encouraged telephone companies to invest substantial sums in building broadband networks capable of conveying greater amounts of information than current technology allows.

¹² See, e.g., 139 CONG. REC. S242 (daily ed. Jan. 21, 1993) (National Competitiveness Act of 1993); 139 CONG. REC. S1437 (daily ed. Feb. 4, 1993) (Emerging Telecommunications Technologies Act of 1993); 139 CONG. REC. S2795 (daily ed. Mar. 11, 1993) (Local Exchange Infrastructure Modernization Act of 1993); 139 CONG. REC. E988 (daily ed. Apr. 21, 1993) (High Performance Computing and High Speed Networking Applications Act of 1993).

cable systems."¹³ Put simply, the Act acknowledges that system expansions and technical quality upgrades are necessary preconditions for increased programming diversity.

Despite the obvious public interest benefits of promoting new technologies and more diversified programming, the Order impedes their introduction. This is because, in all probability, the capital investment in system expansion and upgrades -- including the investment necessary to achieve the national policies identified above -- is the single largest cost directly incurred by cable operators after initial construction. Accordingly, rate increases limited to the GNP-PI, which are intended to recover other costs also incurred by the system operator, will prove grossly insufficient to allow cable operators to recover their investment in system improvements. As a consequence, improvements in cable systems simply will not occur, or at best will occur slowly.¹⁴

¹³ Cable Act, Pub. L. No. 102-385, § 2(b)(3), 106 Stat. 1460, 1463 (1992).

¹⁴ Of course, cable operators will always have to weigh the business opportunities they may lose by not investing in new technologies to meet competition. The only cable systems likely to invest in upgrades at a normal and beneficial (to the public) pace will be those which have access to capital markets because of diversified revenue streams. Whether or not other cable operators can make such investments, given the restraints the Commission has imposed, is a serious question. If they cannot, the ultimate victim will be the consumer, who will be deprived of the benefits of greater programming diversity and infrastructure development.
(continued...)

Faced with competitive pressures and given no realistic alternative, cable operators will be required to file cost of service cases whenever they seek to upgrade their systems. Such a result will create tremendous burdens on a regulatory process already at the breaking point. Moreover, the cost of service mechanism is an inherently slow process that will hinder cable systems from responding quickly to competition, and give unregulated competitors an opportunity to create further delay through manipulation of the process.

Viacom respectfully suggests that a cable system's per channel rate could be adjusted to recover capital investment in system improvements in the following manner. The Commission should require cable systems to depreciate the cost of the plant. In addition, cable systems should be permitted allowances for "plant under construction," debt service, and a reasonable rate of return. When seeking to increase rates because of capital improvements, the cable operator would be obligated, if requested, to present underlying calculations and rationale to the reviewing body.

By allowing for the recovery of capital costs in this manner, the Commission would promote important federal

¹⁴(...continued)

Other potential losers are American companies trying to participate in the global optical fiber industry. Without a home market, as foreign competitors have, it will be very difficult for them to compete.

policies, alleviate substantial pressure that cable systems currently face to resort to cost of service cases, and would preserve the proper incentives for cable operators to make the desired investments. Viacom believes that the modification proposed appropriately balances the many important national interests contemplated by the Cable Act and would be relatively simple to implement.

B. Guidelines for Calculating Permissible Pass-Through Costs for Programming Should Be Revised

In its Order, the Commission recognizes that "programming costs have increased at a rate far exceeding inflation."¹⁵ Because capping such rate increases at the GNP-PI would not allow cable operators to recoup these costs, the FCC has determined to permit pass-through of the costs of acquiring cable programming. As its rationale for this policy, the Commission states that "[t]reatment of programming cost increases as external costs would assure programmers' continued ability to develop, and cable operators' ability to purchase, programming."¹⁶ As developed, however, the policy fails to achieve this objective.

¹⁵ Order at 157.

¹⁶ Id. at 157.

1. Costs of Affiliated and Non-Affiliated
Programming Services Should Be Treated
Identically

Although the Commission recognizes the need to pass-through programming costs to ensure the continued development of programming, the Order expressly limits the pass-throughs permitted for programming services affiliated with the cable operator.¹⁷ Specifically, under the new rules, pass-throughs of increases in programming costs attributable to affiliated program services are to be capped at the annual incremental percentage increase in such costs or the GNP-PI, whichever is less.¹⁸ As indicated above, this limitation would significantly understate the costs of acquiring cable programming from entities even marginally affiliated with the operator.

Despite this inequity, the Commission has articulated no reasonable basis for this disparate treatment of otherwise identical programming costs. Unquestionably, the public interest rationale justifying recovery of non-affiliated

¹⁷ Under the rules, "an affiliated programmer is a programmer with an ownership interest of 5 percent or more including general partnership interests, direct ownership interests, and stock interests in a corporation where such stockholders are officers or directors or who directly or indirectly own 5 percent or more of the outstanding stock, whether voting or nonvoting. Such interests include limited partnership interests of 5 percent or greater." Order at 158, n.601.

¹⁸ Id. at 158.

programming costs applies equally to costs of programming acquired from affiliated entities. The Commission's concern about cost-shifting in the case of affiliated programming is wholly conjectural. Given this, there is no justification for adopting extreme measures prematurely.

The Commission can address cost-shifting problems if they arise by, for example, permitting the affiliated cable operators to pass-through at least the average increases levied upon non-affiliated systems of comparable size without a GNP-PI deduction. Viacom submits that the public interest would be better served by this solution and reserving draconian measures for instances when a problem exists.

2. Programming Costs Should Contain a Profit Component

Further, it is critical that the Commission's regulatory scheme provide incentives for cable operators to continue to add new programming. It does not. Cable operators are reacting to the new rate regulations by seeking new sources of revenue to compensate for their projected cash flow reductions. By precluding a profit component in programming pass-throughs, the newly adopted rules have undermined any incentive to add cable programming on tiers. Rather, it has created an incentive to offer new programming on an unregulated, a la carte basis. This is not a satisfactory result for either cable operators or programmers.

Launching a new program service on an a la carte basis is prohibitively expensive for programmers.¹⁹ The costs of promoting new a la carte services are very high, and advertising revenues of a la carte services are generally

regulation or 180 days after the effective date of our regulations adopted in this Report and Order,²⁰ whichever occurs first."²¹ The public interest, however, is not served by an initial pass-through date that does not allow cable operators to recover increases in external costs beginning October 1, 1992.

As an initial matter, there is simply no logic to support any difference in treatment during the gap between October 1, 1992 and the date on which pass-throughs can begin to be assessed. As noted above, the benchmark rates are a static pre-October 1, 1992 view of the cable industry. Further, the GNP-PI inflation adjustment permitted by the Commission's benchmark, from September 30, 1992 to the date rates become regulated, is not intended to apply to external costs. Rather, it merely adjusts routine "internal" costs to keep pace with inflation. Setting the initial pass-through date at a time significantly after cable rate regulation begins -- which now will not occur before October 1, 1993 -- means that cable operators will not be able to recover at least a full year of external cost increases, and thus will not be fairly and adequately allowed to cover their costs.

²⁰ By Order adopted June 11, 1993, the Commission postponed the effective date of these regulations from June 21, 1993 to October 1, 1993.

²¹ Order at 160. Changes in costs occurring prior to that date will not receive external treatment.

This gap may result in delaying the implementation of system improvements and additional service offerings. If cable operators are not able to recoup the costs they incur for new programming and other system improvements until a later date, there will be strong incentive for them to delay such investments until such time as the costs are eligible for recovery. Clearly, the public would not be served by providing such incentives. Accordingly, Viacom urges the Commission to set the initial pass-through date as October 1, 1992.

III. PERMISSIBLE RATES FOR EQUIPMENT MUST INCLUDE PROMOTION COSTS

The Order also establishes "standards for setting, on the basis of actual cost, the rates for installation and lease of equipment used by subscribers to receive the basic service tier, and installation and lease of monthly connections for additional television receivers."²¹ However, these standards specifically exclude costs incurred by cable operators for promotions associated with such equipment. Viacom submits that a full and fair recognition of the actual costs associated with the provision of cable service requires the inclusion of these costs.

Cable operators commonly offer promotions to new

²¹ Order at 170.

subscribers, including a below cost offering of certain equipment and installations. The Order correctly concludes that "cable operators [should] be afforded substantial discretion to offer [such] promotions."²² Not only does the customer directly receiving the promotion benefit, but so do all customers of the cable operator. Subscribers attracted to the service by promotions will increase the total number of customers, thus facilitating economies of scale with their accompanying cost savings.²³

The Order prohibits the inclusion of promotion costs as part of equipment charges, despite a recognition of benefits that promotions can bring to the public.²⁴ Yet, promotion costs are a legitimate cost of doing business that needs to be recouped by cable operators. If the regulations are designed to establish fair and adequate rates, they must reflect these costs. As discussed above, failure to recoup the actual costs of doing business could result in service degradation or hinder further system development.

²² Order at 190. "The cost of a promotion is the difference between a charge based on our prescribed actual cost methodology and the promotional charge." Id. at 190, n.735.

²³ The Commission's benchmark tables confirm that the costs per channel decrease as the number of system subscribers increases. Order at Appendix D.

²⁴ Id. at 190.

IV. CERTAIN OTHER PROCEDURAL ASPECTS OF THE ORDER REQUIRE RECONSIDERATION OR CLARIFICATION

A. The "Competitive Necessity" Doctrine Should Apply to Cable Rates

The Order concludes that the "uniform rate structure" provision of the Cable Act does not preclude cable operators from establishing reasonable classes or categories of service with different rates and terms, provided the rate structure containing these differentiations is uniform throughout a cable system's geographic service area.²⁵ As such, the Order finds permissible uniform, non-predatory bulk discounts to multiple dwelling units ("MDUs"), senior citizens and new subscribers.²⁶ Viacom seeks clarification that the Cable Act also permits cable operators to offer discounted service pursuant to the Commission's longstanding "competitive necessity" doctrine. This is necessary to meet competition from multi-channel video distributors, such as SMATV systems, that are permitted to negotiate individual agreements, particularly with MDUs, without a non-discrimination obligation.

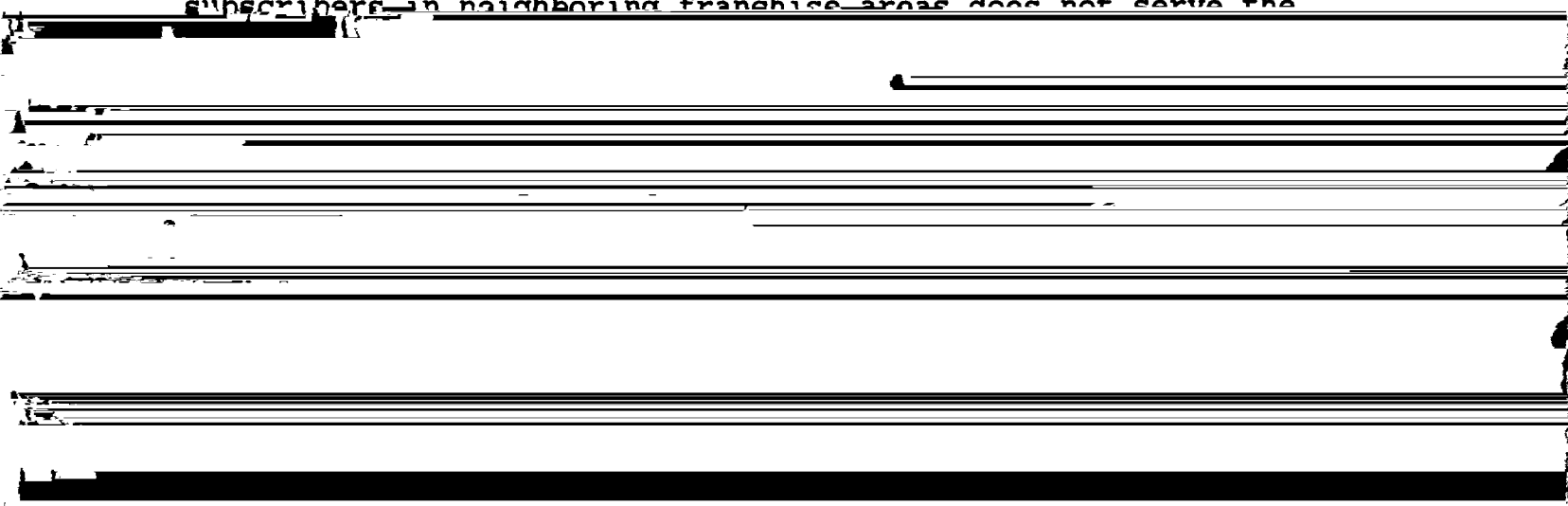
²⁵ Id. at 260-72.

²⁶ Id. at 267.

B. Where a System Covers Multiple Franchise Areas,
Consistent System-Wide Rates Should Be Permitted

The Order provides that rates charged to subscribers for basic cable and other tier services are to be calculated with respect to each franchise area in which the operator provides service.²⁷ Yet, in cases where an operator's system covers more than one franchise area, service rates calculated under the benchmark formula could vary slightly among such areas, even though the identical service is being provided to each franchise area.²⁸ Viacom asks that cable operators be allowed, in such situations, to calculate rates on a uniform system-wide basis. Moreover, it should be proper to advertise this uniform rate while noting merely that different franchise fees and other itemized costs may result in different total charges (uniform rates plus differing franchise-specific itemized costs) in different franchise areas served by one system.

Requiring an operator to charge different rates to subscribers in neighboring franchise areas does not serve the



Moreover, subscribers will not readily understand why they are charged a higher rate than their neighbors for the identical cable service. The education process will be difficult and costly -- and serve no purpose. Viacom submits that the public interest would be served by permitting operators to calculate and advertise a uniform service rate throughout a multiple franchise system.

C. The Effective Date of Unobjectionable Rate
Increases Should Not Be Delayed Pending Review of
Other Portions of the Overall Rate

In most cases, when a cable operator submits its proposed rate increases for review, one can expect that the reviewing authority will initially find some portions justified, while others subject to further analysis. Viacom requests that, in such instances, the reviewing authority be instructed to permit those portions of the rate increase that it found reasonable to take effect immediately.

Such a policy would be fully consistent with the Commission's rate review practices -- and Congressional intent -- in other contexts. With respect to review of telephone rates, Section 204(b) of the Communications Act provides that

. . . the Commission may allow part of a charge, classification, regulation, or practice to go into effect, based upon a written showing by the carrier or carriers affected, and an opportunity for written comment thereon by all affected persons, that

such authorization is just, fair and reasonable.²⁹

The purpose behind this policy is to allow rate regulated service providers to recoup the costs of their service as fully as possible. Because requested rate increases are based on actual costs, delays in the approval of new increases limit the entities' ability to recover these costs fully.

This same rationale is equally applicable to the cable context. If cable operators are to continue to provide quality service to customers, they must be able to recover their costs of doing business. A policy instructing the applicable reviewing authority to permit unobjectionable portions of proposed rate increases immediately to go into effect, therefore, would serve the public interest.

D. Evidentiary Hearings Should Be Available When Necessary to Protect Cable Operators' Rights

The Order provides that local franchising authorities should have the flexibility to "decide for themselves whether and when to conduct formal or informal hearings as long as they act on rate cases within the prescribed time periods we have established and provide interested parties with notice and meaningful opportunity to participate."³⁰ This passage

²⁹ 47 U.S.C. § 204(b) (1991).

³⁰ Order at 86.